

CalPERS INVO Webinar – 6/1/11

Date: June 1, 2011
Segment: CalPERS Investments Office Professional Series: Webinar
Introducing Emerging Managers to CalPERS Investments
Call Operator: Craig Rabin
Speaker: Bob Burton
Presenter: Tim Legesse

Audio Transcript

Call Operator:

Again, I would like to welcome you to introducing emerging managers to CalPERS Investments. Without any further delay it is my pleasure to hand the floor over to our first presenter. And, Bob, you now have the floor.

Bob Burton:

Good morning from the CalPERS headquarters in Sacramento. And, welcome to this one hour Webinar, an interactive vehicle for introducing emerging managers to CalPERS investments.

The first rule of making an investment presentation is know your audience, your customer. In the minutes ahead we'll show you, as emerging managers, how to improve your opportunity to do business with California Public Employees Retirement System; We'll show you how to learn more about us by using tools within your reach on the CalPERS website. Opportunity no longer knocks, it clicks its way toward effectively understanding CalPERS. From its formation in 1932 to provide retirement support for state workers, CalPERS has grown into the largest public employee's pension fund in the U.S. managing retirement benefits for 1.6 million members, retirees and their families.

Our mission is the financial wellbeing and the health of our members. CalPERS is lead by a 13 member board of administration, which is charged with the fiduciary duty to manage the fund in the best interest of CalPERS members. The CalPERS Investment Office manages a diverse portfolio with global reach. Currently, the \$234 billion dollar fund produces investment returns that provide 64 cents of every dollar paid to CalPERS retirees. CalPERS has adopted an assumed rate of return on its investments of 7.75%, a long term risk adjusted return. The money for payment of pension benefits comes from three sources, this CalPERS pension buck illustrates the 15 cent contribution of CalPERS members and the 21 cent contribution of their public employers. It also underscores the 64 cents of every pension dollar provided by CalPERS investment earnings.

Your key to understanding CalPERS as a customer is to understand and utilize the CalPERS Investment Office Website. Here now to help you understand CalPERS as a customer is Tim Legesse, CalPERS Investment Officer for Diversity. Tim, take it away.

Tim Legesse:

Thank you, Bob. That was Bob Burton from our Public Affairs Office who gave you an organizational overview of CalPERS. I'm pleased to be here today to introduce you to our Investment Office, its programs for new and emerging investment management firms, and what CalPERS is doing to open doors to them. A couple of administrative matters, the chat room is open for questions, so please feel free to pose one. And this slide presentation will be made available after this webinar.

CalPERS is the largest public pension fund in the United States with assets of more than \$234 Billion dollars. We seek the best risk adjusted investments for the benefit of our 1.6 million members. We invest with emerging managers because we think your ideas and fresh perspectives can lead us to new and expanded investment opportunities that benefit our fund and our beneficiaries.

CalPERS assets are invested globally. As Joe Dear, our Chief Investment Officer has commented to me, we are invested in just about anything, just about anywhere in the world. Our global equity portfolio comprises the largest segment of the total fund. It's invested in stock of more than 9,000 listed companies operating in 46 countries across all industry sectors. Approximately 70% of our global equity portfolio is internally managed.

CalPERS international investment program began in 1989 and has been increasing investments in emerging markets across the investment portfolio. This strategy of investing internationally and in emerging markets is present in private equity as well, which has a broad emphasis of growth investing. Meanwhile, in private real estate markets our emphasis is shifting back to core assets primarily based here in the United States. Our investment mission simply is to seek out the highest possible returns with acceptable levels of risk, hence we seek best risk adjusted investments.

The Investment Committee of CalPERS Board of Administration oversees the Investment Office. The Investment Office implements the Board's approved policies. Headed by Joe Dear, our Chief Investment Officer, the Investment Office employs approximately 250 professional investment officers and support staff, making it one of the largest among pension plan sponsors globally, both by assets under management and staff size.

Setting investment policies is the primary task of CalPERS Board. Who, in December of 2010 approved a new risk based allocation, model and framework to set the direction for CalPERS. Over the next three slides I'll walk you through a newly improved investment plan.

The Asset Allocation Categories reflect those common among peer investors such as plan sponsors, endowments and foundations and sovereign wealth

funds. The mix, however, varies based on the financial objectives of each investor. Global fixed income for us comprises largely U.S. and other sovereign debt and corporate debt securities and has a target allocation of 22% of total assets. Global equity comprises largely listed stocks, including equity exposure through private equity and hedge funds. This is the largest asset class and has a target allocation of 63%. Both of these asset classes have been increasingly bringing assets in-house under internal portfolio management teams. Global fixed income, for example, currently seeks external portfolio management expertise in global high yield strategies. The rest isn't managed internally.

Real estate comprises largely private market equity investments in direct assets and is targeted at 10% of the total fund. Infrastructure and forestland also in direct investment strategies have a target allocation of 3%. Commodities and cash are each targeted at 1% of the total fund.

Alongside this traditional asset class mixture we overlay five major asset groupings according to how they function in high or low growth markets and prevailing inflation or deflation macro economic environments.

The liquidity grouping functions to reduce deflation risk by providing a storehouse of cash we can readily draw upon to pay benefits, as Bob mentioned. Its principal components are cash and liquid government bonds and securities, such as U.S. Treasuries.

Growth functions to provide the bulk of our long term returns through private and public equity investing. Income consisting of treasury inflation protected securities, or TIPS, and other high grade fixed income securities functions to provide a stable source of income during falling equity markets. Just like the one we experienced during late 2009 and early 2010.

Our real assets comprises of real estate, infrastructure, and forestland investments. It functions as a diversifier to the total portfolio, and yet another source of stable income during falling equity markets.

Inflation protection we really look to commodities, inflation link bonds and forestland, which are expected to be less correlated to equity markets, thereby helping reduce the risk of inflation, eroding our total portfolio.

Inside the Investment Office the investment strategy group chaired by the Chief Investment Officer functions to implement tactical asset allocation; Senior investment officers in each asset class, and the asset allocation team, together review GDP growth trends, inflation, liquidity and interest rate scenarios to form a collective macro economic outlook.

The overlay, as I mentioned, drives how we tactically move assets within bands around the targets that I mentioned with regard to our asset class mix, based on

near and intermediate term outlooks. A key point of having the risk based asset allocation view is to add another dimension in the assessments about risk and return tradeoff in our capital allocation process.

So, now, how do we integrate the ideas new and emerging investment managers offer? CalPERS outreach efforts such as this webinar are components to developing a pipeline of emerging manager opportunities. This activity is part of helping us to develop and maintain our competitive advantage, which drives our success in the ever changing global financial marketplace.

In our view, diversification benefits of investing in emerging managers are threefold. We're always looking for new talent. We hope to partner with tomorrow's industry leaders and that's what we're trying to accomplish. We look to migrate successfully or transition successfully emerging firms as feeders to the core portfolio. Emerging managers also help us to target and capitalize on opportunity than less efficient markets so that we can derive the potential for superior returns. They also help us expand the investable opportunity set.

So, what are characteristics of successfully merging managers? Articulated strategies demonstrating a clear understanding of your sources of risk, that includes your investment strategy and business operations. Whether this is a repeat or first time entrepreneurial effort, it still requires commiserate working capital backing. A clear ownership structure showing alignment among the management team and clearly delineating governance and managerial responsibilities is important. A solid business plan includes a description of resources, product focus, market positioning, and have you appropriately right sized the product? A skilled investment team we measure in the depth of your personnel. You should describe how skilled an investment team's in place. Or, is in the process of being assembled? We'll also be assessing cohesion, or how well the team works together; Not only at investing, but at running the asset management firm. A disciplined investment process speaks to idea generation, or sourcing in private markets.

Pipeline development, due diligence, execution, portfolio management, and your sell or exit strategy, begin in private markets. These are the successful characteristics of emerging firms.

Remember the chat room is open, so feel free to pose a question, and we'll try to answer it during the Q and A period after this webinar.

If we run out of time, you can check back on the website where we'll post frequently asked questions. Also, you can, if you've already posed a question and you want to add another question, just hit the edit button and append to your existing question.

CalPERS provides assets to enable emerging managers to successfully grow from our programs into mainline portfolios in our equity asset classes.

The Manager Development Program was created in 2001 and provides venture capital and investment assets to small and emerging investment management firms in exchange for an equity stake. Its target allocation is two to five percent of global equity assets. The program looks to find and grow long-only public equity managers with less than two billion of assets under management at the time of funding. A unique feature of this program is that it provides venture capital and investment assets to the selected firms. Two program partners source and recommend investments to CalPERS staff. Legato Capital Management and Strategic Investment Group are the current advisors. Again, our intent is to migrate successful firms into the mainstream portfolio.

A prime example of success in this program has been around for over a decade now is Arrowstreet, which manages \$2.5 billion as one of our public equity international managers, and this was an investment in our MDP program in the early days. Also, last month we announced the funding of two new managers and the support for the extension of another's product line. Now, that's an existing manager in the MDP program. Another program in public equities and global equity portfolio is the Emerging Manager Fund of Funds Program, which was implemented in 2007. This program allocates capital to small and emerging public equity managers as well, it has 800 million invested to date, and alongside the Manager Development Program is also targeted at two to five percent of global equity assets. It also seeks to find long-only public equity managers with less than two billion in assets under management. However, unlike the Manager Development Program, it does not seek an equity stake in the firm. Three Fund of Funds with manager selection discretion advise this program.

Fiduciary Investment Solutions, Leading Edge Investment Advisors and Progress Investment Management Company work with our staff to run this program. Once again, our intention is for the successful firms to transition into our mainstream portfolio.

Also launched in 2007 and currently having \$550 million in invested assets is the Fund of Emerging Hedge Funds Program. This is one of the first programs in the hedge fund marketplace. This program invests across the entire spectrum of hedge fund strategies, so it represents a multi-strategy portfolio. Eligible firms for this program are new and emerging hedge funds with less than one billion in assets under management.

Fewer are seeking to fund smaller nimble managers with a proven or demonstrable edge. We're looking for skill in managing downside risks and building scalable business models as well.

Three Fund of Funds with manager selection discretion advised the staff, they are 47 Degrees North, PAAMCO and The Rock Creek Group. Two of them, if circumstances are right, can consider making a day one dollar investment. A unique feature of this program is the integration of a diversity consultant, Mosaic Investment Advisors, who assist staff and the program advisors to help cast as wide a net as we possibly can to find talent within the hedge fund community.

Lastly, the Capital Link Fund is a program in our Alternative Investment Management Program. And it's focused on emerging managers in private equity. This is another program launched in 2007 and currently has committed a billion in capital. The program invests nationally with emerging private equity fund managers pursuing the U.S. based strategies. General partners who are sponsoring their first or second institutional fund are eligible. Generally, these funds have a lower level of limited partner participation by institutional investors. Centinela Capital Partners serves as a specialist advisor to our AIM program staff and manages the program collaboratively. Again, this is a fund of funds structure as well.

Next I'll provide you an overview of the new real estate strategic plan approved earlier this year by the CalPERS Board of Administration, and also share with you what goes into our thinking behind designing a new program for emerging investment managers.

This new real estate investment strategy emphasizes private real estate opportunities versus rates or real estate investment trusts. Which are stock shares in listed companies. The strategy focuses the majority of our portfolio on the United States to create streams of income that reduce our tolerance for risk and back to our functional grouping of providing stable income, both the real and income portions of the asset grouping. Therefore, we will see less emphasis and go after fewer development projects in favor of more stabilized cash flowing assets. Going forward, also, the portfolio will carry less leverage.

Now, under these parameters we can begin to look at evaluating the development of an Emerging Manager Program that integrates the larger asset class strategy, as all of our other programs do in the emerging manager space.

So how can you send us a proposal? And, what's the best way to submit one to us? CalPERS launched the investment proposal online submission service in 2010. It allows skilled managers to submit investment proposals directly to the CalPERS Investment Office. To be considered by any asset class as applicable, proposals are required to include a measurable and attributable track record, where possible, strategic focus, and a geography or industry focus, if you have one. Proposals are evaluated by CalPERS investment staff on a regular and ongoing basis in the selected asset classes. If you inadvertently select the wrong asset class, we will refer it internally before responding back to you. We may refer eligible proposals to our external partners when their criteria is met for the

Emerging Manager Programs, for example, Legato, Strategic, FIS and all the other program advisors.

What other ways are there to contact CalPERS to do business with us? As Bob said, knowing your customer is vital, proposing successful investment strategies. We encourage you to become familiar with our website where you can access all the information presented in this webinar and links to communicate with us.

Other opportunities to do business with CalPERS are available through requests for proposals or requests for information. This process allows applicants the opportunity to, 1) compete to manage assets within our global equity and fixed income asset classes, and also to compete for opportunities to establish a fund of funds for one of our special programs. And, to compete to join our pool of advisors and consultants to the CalPERS Board and staff more specific asset class strategies, planning and the like.

You can register for E-business alerts, which will notify you of current and upcoming opportunities in your selected category. Once again, all this information is contained on our website and we really encourage you to do your homework before submitting a proposal.

Now, I'll turn it over for questions and answers, a Q & A session. And, give us a minute while we're cueing up your questions.

Host:

All right. Fantastic! And, for anyone in our audience who may have missed my earlier introduction, you can ask a question at any point by simply clicking the Q & A button from the upper toolbar and then type your question in next to the Ask Button and go ahead and hit Ask. With that, Tim, I'll pass it back to you.

Tim Legesse:

Great. Thank you, Craig. So, our first question is: What are your plans for future webinars and workshops?

It's a great question. At the end of this event we'll provide you a survey and you'll have an opportunity to let us know what topics are of interest to you. So we do plan to have more webinars and workshops.

Let's see. Another question is: Will these mandates expand?

Presumably, we're talking about the emerging manager program mandate. An example here is the Manager Development Program, which was started in 2001. And, again, we revisited and looked at what's working and what's not working in 2005. And, today the program is actually referred to as the Manager Development Program II, because it's in its second phase since it was first constructed and designed and implemented by staff after board approval. So we

constantly look at our programs for opportunities to expand them and improve them to meet the needs of the marketplace, but more importantly to meet the needs of an ever evolving CalPERS. As I mentioned, we have a new investment plan in integrating everything in a holistic view is really important as we look for building successful programs.

We have another question: How long will it take to hear back after submitting a proposal?

That's a great question. Our goal is to respond back to proposals within 90 days of submission. That's our internal service level goal. And, again, this is a new online service, so we're working really hard to meet that goal and accomplish it. So, we really appreciate those proposers who send in their proposals and are waiting to hear back that, you know, we've got to go through our cue and we really just review them as they come in and respond back as appropriate. Sometimes it takes us a little bit longer because as I mentioned earlier, we may need to refer them internally because it's not quite a fit or the asset class that the proposer had selected.

Okay. We have another question: Is CalPERS looking at exposure in any particular strategy?

Currently, we are looking at, the most active portfolios are really in the real assets infrastructure commodities space. That's a new asset class and in relative timing to other asset classes. You know, if you think of global equity and how long it's been an asset class among institutional investors, so this view of inflation protection among peer investors is really come into the four, beginning 2004 and five and, for us in 2008 we had an inflation linked asset class and now we've really integrated it with a real assets use. So there are active searches and active exposure that we're looking there. We also are looking in our global equity and also in our private equity area, and then of course real estate with its new plan and strategy is also restructuring the portfolio, so new opportunities or new exposures we'll be looking for there.

We have another question: Will CalPERS invest directly into venture capital?

So, our preference is to invest in funds in our private equity portfolio. To invest directly in venture would require us to have a direct investment team there. Which we are currently not resourced to do. So, what some of our program advisors might recommend a side by side co-investment. But overall, we are really deemphasizing venture capital. It just hasn't met our return expectations over the last ten years. So that is one area of the portfolio where we are actively looking at our exposure there. But, overall, no, we don't directly invest in specific venture capital investments at the portfolio company level. We will look at funds on a very selective basis.

Here's another question: Can hedge funds submit a proposal to CalPERS, or do they have to go through the advisor?

Yes. You should submit to both us and the advisor. And that way you're in the flow, in the pipeline and flow of both.

Oh, questions are coming fast and furious.

Another question: At what point will the MDP program include hedge funds in addition to long-only.

That's a great question. The MDP is difficult to manage. And, currently doesn't have a hedge fund component to it. But that's a very interesting advice and we'll take a look at that. But, right now there aren't any current plans to integrate the hedge fund portfolio into the MDP portfolio.

We have another question: What happens to sub-managers above \$2 billion dollars?

So, again, if I can refresh everybody's memory, the MDP, or Manager Development Program and the Emerging Manager Fund of Funds Program both have an eligibility criteria of two billion in assets under management or less. So, the successful firms will obviously be able to attract other investors and they will grow beyond \$2 billion dollars. Where there is a fit in our mainstream portfolios we work to transition those firms into the mainstream portfolio once they grow significantly above \$2 billion dollars. So that doesn't happen automatically. If you have two billion 500 million tomorrow, right? They get a big mandate. We need to know that you grow well and you have that scalable model and everything's working. So. And then we have to find a fit for you in the mainstream portfolio with specific strategy.

There's a great question: Are there efforts to invest in women and minority owned firms?

Absolutely. As I mentioned in the Hedge Fund of Funds Program we've integrated Mosaic Investment Advisors, who is part of our diversity consultant pool. And, so this is a pilot that we did, a very unique feature, and it has helped us to cast a wider net and integrate women and minority owned firms who typically have been overlooked or under served from time to time in the asset management industry. So, yes, that is a big part of our outreach effort.

Another question here: What's the difference between MDP and the Capital Link Fund?

Quite simply the difference is the Manager Development Program is focused on long only public equity managers. So this is your large caps, small cap, or utility

sector fund, so, really investing in publicly traded stocks. The Capital Link Fund is in our private equity asset class and portfolio, and that is really going after private equity funds. Again, as I mentioned, general partners who are sponsoring their first or second private equity fund.

One second. Still cueing up some questions and, but keep them coming, they're really good.

Got a question here: Will managers hear back if a proposal is declined?

Absolutely. We will, as I said, we'll try to get back to in 90 days. Sometimes it will take a little longer. And you will definitely hear back from us that we reviewed and declined it. Now, that may be because your stage of development, your strategy weren't exactly a fit for one of the programs that you sent a proposal for. However, there's nothing that stops you from resubmitting an investment proposal as you hit more milestones along your path to executing on your business plan. Remember the elements of the business plan. Right? So perhaps you approached us before you fully assembled the team. Or, you were missing key components, for instance, operations and risk management, and hadn't brought that identified professional on board. So that's, those are critical areas, and most typical of what I see as far as proposals I've reviewed.

We have a question here on the real estate program: What is the anticipated timeline for implementing the real estate emerging manager program?

Well, in February we got our new strategy and investment plan in place. So, the current update I can give you is that we've retained a consultant to help us evaluate the size of the manager universe. And, also, what are parameters we should have? For instance, what is the assets under management to be eligible? So, once that research is completed by our staff we will make a recommendation to the Investment Strategy Group and then to our Investment Committee and we'll go from there. So, we're really in the early to middle stages on completing that evaluation. And, that's the update I can give you at this time. But stay tuned, again, if you go to our website and do key word searches you can track the evolution of that through our Investment Committee Agenda items, which are available on our website.

All right. Great questions. So please keep them coming. We've got plenty of time here.

So, how do we contact your Fund-of-Fund managers?

Great question. Again, if you go on our website and you look into the individual asset classes, you will find a link to our Fund-of-Fund advisors web pages and their contact information. And, again, when you submit a proposal to us, if we think it's a fit and of merit, we will certainly refer it on to our program advisors.

Very good question. So we have a question here. How critical is valuation of assets held to your performance measurement?

So this is a, typically a private market question where the valuation is in instantaneous publicly traded stock quotation on an exchange. Right? So you can just go to NASDAQ and look up Google and you'll get a valuation of the company today. So, in private equity they have a fund that owns several portfolio companies and the general partner will value them on a quarterly basis. So this question is asking how important it is. Is it vitally important. And, we scrutinize your valuation as much as, you know, data and support that you have behind them. So, the ability to justify and defend valuations is crucial. And, thank you for that question. So, performance measurement, also when you're sending in your proposal we'll certainly be doing a litmus test on that valuation because it's an integral part of your track record.

Just a minute while we're cueing up a couple more questions. But keep them coming. Thank you.

Oh, we have a great one here. So, the presentation and frequently asked questions, will they be posted following this event?

Absolutely. It will just take us time after we close the webinar to aggregate those questions that are being frequently asked, and the ones that we haven't addressed in this webinar, and we'll post them as quickly as we can after doing research to answer those questions.

We have another one. Did your private equity allocation include direct allocations to merging managers. I'm sorry. Let me repeat that question. I apologize. Does your private equity allocation include direct allocations to emerging private equity funds outside of the capital link fund?

Yes. Actually, before implementing the capital link fund strategy in 2007, we did invest directly with general partners sponsoring their second time institutional fund. The AIM Program was started in 1989, the Alternative Investment Program, or Private Equity Program. And, over time with recognition of success in backing second time funds, we also went to the Board and got their approval to invest in first time fund sponsors. So we have a number of firms in our private equity portfolio over the history that, of the AIM program, that were first time or second time funds. We don't have a discrete allocation, and we will look to upsize our commitment on a selective basis, of those that Capital Link brings to us. And there's nothing preventing us. Also, if you're in emerging markets or clean tech and some other strategies, we have other programs like the Capital Link Fund that are probably a better fit for you. And, so, nothing prohibits you from contacting those funds as well, and those Fund of Funds advisors. And you

can find their links and addresses and contact information on our website as well. And, so, go to the AIM, Alternative Investment Management Program.

We're coming up to the close of our session, but I'll take one or two more questions, if I can.

Okay, this one is a multipart question. What is the minimum fund size CalPERS would consider investing in?

So, that's really a function, and I assume that's a direct investment question. So, the minimum fund size is really a function of how much capital the strategy requires. It also is a function of where we are in the AIM program structure, or if it's a hedge fund structure, how close we are to our target allocation. And, so, the fund sizes really differ by asset class. So I'll just address private equity just to give you our thinking there. If that's, uh, I think this question is private equity related. So, basically, we have over 300 plus relationships, if you look through our fund of funds and our directs. So, wide sizing or restructuring that portfolio is something we're going, in the process of undertaking it currently. So, if going forward we want to invest in commitment sizes of roughly \$75 million to a \$100 million. So, and we don't really want to be more than 20% of the fund size. So if you sort of do the math, you need to be at somewhere between four, three to 500 million in fund raise size, and your strategy needs to justify that, and your team size and all the other components that we mentioned about what the characteristics of a success firm are for us to invest directly with you. And that's kind of a long answer, but that's generally where it is now. Depending on, you know, all the money that we've committed and we're getting really good distributions back, you can obviously look to rethinking the portfolio.

Okay, we have time for one more question. But, these are terrific questions, so please keep them coming in. And, again, we're going to really trying to answer all of those that have been frequently asked and, also pose a presentation on the webinar presentation on our website.

So, final question. Do you give California based managers preference in the Emerging Manager Fund of Funds Program?

We do not give California based managers a preference. We certainly invest in California broadly and there's an agenda item to our investment committee on that that we presented a couple months ago. So there isn't a preference, but certainly being in California we do get a lot of investment proposals from California based managers. So there is no California investment preference. However, in private equity we do have a California Initiative, which does look to investing in California's under served markets and that's something, for those of you who are interested, we encourage you to explore.

So, we're coming up to about five more minutes left in our session here. And, I want to thank you all for your participation and your really great questions.

If you have additional questions, you can always ask us and submit them through our website at www.calpers.ca.gov, and it's very simple. You'll find a link called Ask CalPERS, bottom right hand corner of the Investment Office Landing Page.

So, with that I will turn it over to Craig, and Craig will be sending you a quick survey. So we really value your feedback, and if you take a few minutes to fill this out and let us know what you thought of this session, we'd be grateful. And thank you for your time.

Call Operator:

All right. Fantastic! Great presentation there, Tim. As Tim just mentioned, the survey slide is now up for you. And the feedback and opinion site you give to us, this allows us to create a better web cast for you in the future, so your feedback is greatly appreciated. If you do have additional questions or concerns, please continue submitting them in the question and answers pane and we will get them addressed.

Thank you again for joining us on today's presentation and you can now disconnect from the audio portion of today's conference.

End of Audio Transcript